STATE OF MICHIGAN
IN THE SUPREME COURT

APPEAL FROM THE MICHIGAN COURT OF APPEALS
JUDGES MARKEY, FITZGERALD and OWENS

CARSON FISCHER, PLC,

Plaintiff-Appellee,

v.

MICHIGAN NATIONAL BANK and
MICHIGAN NATIONAL CORPORATION,

Defendants-Appellants.

Supreme Court No. 128689

Court of Appeals No. 248167

Oakland County Circuit Court
No. 01-029814-CZ
Hon. Rudy J. Nichols

BRIEF OF APPELLEE CARSON FISCHER, PLC
ORAL ARGUMENT REQUESTED

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COUNTER-STATEMENT REGARDING JURISDICTION

Appellee-Plaintiff Carson Fischer, PLC (the "Firm") agrees that this Court has jurisdiction under MCR 7.301(A)(2) to review a decision of the Court of Appeals.

However, based on the brief of Appellant Michigan National Bank ("MNB"), which relies on disputed facts and speculation about facts not in the record, the Court should decline to exercise its jurisdiction and dismiss the appeal because, on this record, it does not involve "legal principles of major significance to the state's jurisprudence" or any of the other grounds stated in MCR 7.302(B).

COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Should this Court decline to exercise its jurisdiction because this case, on this record, does not raise "legal principles of major significance to the state's jurisprudence" where (1) MNB's brief demonstrates that MNB is rearguing factual contentions, asking this Court to consider the record evidence in the light most favorable to MNB and to speculate about evidence not in the record, (2) neither the Circuit Court nor the Court of Appeals made any determination about the factual or legal significance of the entries on the "Memo" line of the Firm's checks, (3) MNB did not present evidence on the meaning or significance of the "Memo" line in the trial court, (4) the UCC itself establishes that entries on the "Memo" line do not, as a matter of law, constitute "alterations" to the checks because they do not alter the "payee" of the instrument or change the Firm's obligation?

Appellee Answers: No.

The Court of Appeals did not consider this question.

Appellants Answer: Yes.

2. Did the Court of Appeals correctly determine that this case was controlled by UCC Section 4-401, MCL 440.4401, rather than UCC Section 4-406, MCL 440.4406, where the evidence presented to the Circuit Court did not establish, as a matter of law, that the Firm's checks contained unauthorized signatures or material alterations within the meaning Section 4-406?

Appellee Answers: Yes.

The Court of Appeals Answered: Yes.

Appellants Answer: No.

3. Can MNB establish unauthorized signatures or material alterations where MNB did not offer any competent evidence that the signatures were unauthorized or that there was any material alteration but, at best, offered speculation that entries on the "Memo" line of some of the Firm's checks referred to an account which Rasor maintained at MNB, especially where MNB did not offer any evidence that MNB relied on, or even considered, the entries on the "Memo" line and where the information presented to the Firm, in the form of checks and bank statements, did not disclose payments to Rasor or any unauthorized signature or material alteration?

Appellee Answers:	No.
The Court of Appeals Answered:	No.
Appellees Answer:	Yes.

COUNTER-STATEMENT OF MATERIAL PROCEEDINGS

This case addresses which of two sections of the Uniform Commercial Code[1] control the liability of MNB when, presented with checks payable to MNB, it did not credit the Firm's account but instead credited the account of Chip Rasor, an employee of the Firm who was engaged in an embezzlement scheme.

The Firm contended that MNB was liable under UCC Section 4-401 because the Firm's checks were not "properly payable" to Rasor but were only "properly payable" to MNB for the benefit of the Firm. The Firm's position was based on the language of Section 4-401 and a rule establish by federal and states cases throughout the United States, including prior precedent in Michigan Court of Appeals.[2]

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[1] The Firm recognizes, as this Court most recently explained in *Hoerstman General Contracting v. Hahn*, ___ Mich. ___ (No. 126958, March 23, 2006), that the Uniform Commercial Code controls and preempts contrary common law rules. Here, as Court of Appeals found, UCC Section 4-406, MCL 440.4406, by its terms does not control under the facts of this case, viewed in the light most favorable to the Firm. The controlling provision, therefore, is Section 4-401 and common law principles which were not displaced by Section 4-401. Instead, as courts throughout the United States explain, Section 4-401's "properly payable" rule codifies the common law rule. *See Pamar Enterprises v. Huntington Banks*, 228 Mich.App. 727, 735; 580 N.W.2d 11 (1998) (citing cases) and cases cited in Footnote 2 and p. 24 below. UCC Section 1-103, MCL 440.1103, which provides: "Unless displaced by the particular provisions of this act, the principles of law and equity . . . shall supplement its provisions.

[2] *See Allis Chalmers Leasing Services Corp. v. Byron Center State Bank*, 129 Mich.App. 602, 341 N.W.2d 837 (1983); *Dalton & Marberry P.C. v. National Bank, N.A.*, 982 S.W.2d 231, 233 (Mo. 1998); *Master Chemical Corp. v. Inkrott*, 563 N.E.2d 26 (Ohio 1990); *Arvada Hardwood Floor Co. v. James*, 638 P.2d 828, 830 (Colo.App. 1981); *Bank of So. Maryland v. Robertson's Crab House, Inc.*, 389 A.2d 388, 395-97 (Md.App. 1978); *PWA Farms, Inc. v. North Platte State Bank*, 371 N.W.2d 102, 105 (Neb. 1985); *Mutual Service Cas. Ins. Co. v. Elizabeth State Bank*, 265 F.3d 601 (7th Cir. 2001); *Transamerica Ins. Co. v. U. S. Nat. Bank of Oregon*, 558 P.2d 328, 332-335 (Ore. 1976); *Federal Ins. Co. v. NCNB National Bank of North Carolina*, 958 F.2d 1544, 1549 (11th Cir.1992); Annotation, *Liability of bank for diversion to benefit of presenter or third party of proceeds of check drawn to bank's order by drawer not indebted to bank*, 69 A.L.R.4th 778 (1989); 2 White & Summers, *Uniform Commercial Code* § 21-3 (4th ed.) (discussing "properly payable" rule under Section 4-401).

MNB contended that the case was controlled by UCC Section 4-406 because the Firm's signature on the checks had been forged[3] or the checks had otherwise been altered.[4] If so, MNB contends, the Firm had a duty to notify MNB of the forgery or alteration within one year (or less) or its claims would be barred.

Based on the record evidence, the Court of Appeals properly concluded that Section 4-401, not Section 4-406 controlled; and, therefore, applying well-established legal principles which have not been displaced by the UCC, *see* Footnote 2, the Court of Appeals held that MNB was liable for the monies improperly paid to Rasor.

MNB now asks this Court to reverse the Court of Appeals either by construing MNB's factual contentions in the light most favorable to MNB or by accepting MNB's speculation about the significance of facts which were not considered by the trial court. In essence, MNB asks this Court to make an advisory opinion about what the evidence, considered in the light most favorable to MNB, not the Firm, might mean. Consistent with its constitutional obligation, this Court should decline to render such an advisory opinion.

When it granted leave, this Court questioned whether notations in the "Memo" section of the Firm's checks could establish that the Firm's checks had been "altered."[5] As a matter of law,

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[3] UCC Section 1-201(43), MCL 440.1201(43), states: "(43) 'Unauthorized' signature means one made without actual, implied or apparent authority and includes a forgery. *See also King of All Manufacturing, Inc. v. Genesee Merchants Bank & Trust Co.*, 69 Mich.App. 490; 245 N.W.2d 104 (1976) (quoting Section 1-201).

[4] UCC Section 3-407(1), MCL 440.3407(1), states: "'Alteration' means (*i*) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (*ii*) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party."

[5] The Court's order stated: "On order of the Court, the application for leave to appeal the February 8, 2005 judgment of the Court of Appeals is considered, and it is GRANTED. The parties are directed to include among the issues to be briefed: (1) whether the insertion of

an alteration to the "Memo" line cannot constitute an "alteration" within the meaning of the Code because it does not change the named payee — established by the "pay to the order" line[6] — nor does it otherwise change the customer's obligation.

The Court's order granting leave also asked whether, if there was no alteration, the checks were "properly payable." They were. UCC Section 4-401(1), MCL 440.4401(1), states: "An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank." Under UCC Section 3-109, MCL 440.3109, the checks were payable to "order," that is, to the identified payee, MNB. Because the identified payee was a bank, it had the duty to deposit the funds to Carson Fischer's account. Carson Fischer intended and authorized that the checks be deposited by MNB for the benefit of the Firm. However, they were not "properly payable" to Rasor because the Firm did not intend, or authorize, MNB to deposit the checks for the benefit of Rasor.

Assuming there might be a case where notations in the "Memo" section could be deemed to change the "payee" or otherwise alter the drawer's obligation, this is not the case. The record is incomplete on this issue because it was not an issue in the Circuit Court. MNB did not offer competent evidence about the meaning, or significance, of entries on the "Memo" line of the Firm's checks. MNB did not contend, much less offer undisputed evidence, that it relied on the

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personal loan numbers on the face of embezzled checks made payable to the order of Michigan National Bank was an "alteration" of the checks as that term is utilized in MCL 440.4406 and MCL 440.3407 and (2) if the checks did not contain an "alteration," whether they were therefore properly payable under MCL 440.4401(1)." *Carson Fischer, PLC v. Michigan National Bank*, 474 Mich. 986, 707 N.W.2d 590 (2005).

[6] UCC Section 3-103(1)(f), MCL 440.3103(1)(f), defines "order" to mean "a written instruction to pay money signed by the person giving the instruction. . . . An authorization to pay is not an order unless the person authorized to pay is also instructed to pay." As a matter of law, the "memo" line is not an "instruction" to pay.

entries on the "Memo" line when it transferred monies from the Firm's account to Rasor's account. The Circuit Court made no determination based on the content of the "Memo" line.

MNB's appeal should not only be dismissed because it ignores the records and distorts the language of Section 4-406, but because it would lead to an absurd result imposing duties on banks to examine not just the "pay to the order" line of a check, but also the "memo" line, and requiring banks to speculate whether some entry on the "memo" line allows or requires the bank to pay someone other than the person[7] identified in the "pay to the order" line. This would bring banking, at least in Michigan, to a halt because no bank could satisfy that duty without engaging in a check by check inquiry into the maker's true intentions based on the entire content of the check.

I. The Circuit Court's Rulings

On November 27, 2002, the Circuit Court granted MNB's motion for partial summary disposition. The Circuit Court held that the Firm's claims were preempted and limited by UCC Section 4-406, and the Circuit Court limited the time period for which the Firm could seek damages to 30 days. *See* Opinion and Order Granting MNB Partial Summary Disposition (304a-310a). The Circuit Court did not refer to, or rely on, any facts relating to the "Memo" line of the Firm's checks. The issue was not considered, directly or indirectly, by the Circuit Court. Nor did MNB produce any evidence in connection with its motion which suggested, much less demonstrated, that MNB somehow relied on the "Memo" line in making its decision to credit Rasor's account with the Firm's money.

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[7] UCC Section 1-201(30), MCL 440.1201(30), defines a "person" to include "an individual or an organization."

The Firm timely filed a motion for reconsideration. The Firm relied on the rule stated in *Allis Chalmers* which properly applied the Uniform Commercial Code and concluded that Section 4-401 controls. The Circuit Court denied the Firm's motion on January 6, 2003. *See* Docket (xxx-a). The Circuit Court gave no reason for its doing so. The Circuit Court did not refer, directly or indirectly, to the "Memo" line.

MNB filed another motion for partial summary disposition, seeking the dismissal of the claims for aiding and abetting breach of fiduciary duty (Count I) and aiding and abetting tortious conduct (Count II). The Circuit Court granted this motion by an Order dated March 6, 2003, which incorporated the Court's reasoning provided on the record at a March 5, 2003 hearing. The Circuit Court dismissed Count I because it concluded that the Firm did not offer sufficient evidence to establish that MNB had "knowledge" of the Fraudulent Scheme and that the Firm had not offered evidence to establish a special and substantial relationship with MNB beyond that created by the customer/bank relationship. The Circuit Court also found that the Firm was required to, but failed to, present evidence that the Bank had a duty to "control" Rasor before the Firm could establish an aiding and abetting claim against the Bank. In addition, the Circuit Court held that the Firm was required to, but did not, identify an underlying tortious act in addition to a breach of fiduciary duty to impose liability. *See* March 5, 2003 Hearing Transcript (312a).

Again, however, the Circuit Court made no reference to the "Memo" line in its Opinion. Again, MNB produced no evidence to suggest, much less demonstrate, that it relied upon, or otherwise considered, the "Memo" line when it decided to credit Rasor's account with the Firm's money.

Based upon the November 27, 2002 and March 6, 2003 rulings, the Firm was left with a UCC claim to recover damages for an approximately 30-day period. A voluntary dismissal of the remaining claims was entered on April 11, 2003. *See* Docket (xxxi-a).

II. The Court Of Appeals' Decision

On February 8, 2005, the Court of Appeals issued its unpublished Opinion affirming, in part, and reversing, in part, the Circuit Court's rulings. *Carson Fischer, PLC v. Standard Federal Bank*, 2005 WL 292343 (Mich.App. 2005) ("Court of Appeals Opinion"). (331a).

The Court of Appeals held that MNB was liable because the Firm's checks were not "properly payable" to Rasor within the meaning of Section 4-401, which only permits a bank to charge a drawer's account for "items" — here, the Firm's checks, *see* UCC Section 4-104(i)— which are "properly payable" to the party paid.

Where the identified "payee" on a check is a bank, the check is "properly payable" to the bank for the benefit of drawee of the check. Thus, the checks were "properly payable" to MNB for the benefit of the Firm, not for the benefit of Rasor.

The checks were not "properly payable" to Rasor because he was not an identified "payee" and because the Firm did not intend payment to Rasor. *See* UCC Section 3-110, MCL 440.3110. Because MNB paid Rasor, even though the checks were not "properly payable" to Rasor, MNB was liable for all amounts which it had improperly paid to Rasor.

The Court of Appeals rejected MNB's contention that the Firm's claims were subject to the limitations period in Section 4-406 because Section 4-406 applied only to checks which contained an unauthorized signature or a material alteration. Based on the record evidence before, the Court of Appeals determined that MNB had not identified any forged signatures or material alterations.

In reaching this conclusion, the Court of Appeals relied on the well-established rule stated in its prior *Allis Chalmers* opinion and in other federal and state courts throughout the United States construing Section 4-401. *See* Footnote 2.

COUNTER-STATEMENT OF FACTS RELEVANT TO THE ISSUE BEFORE THE COURT

Rasor's embezzlement scheme had two parts: First, using fraudulent documents designed to disguise his prior bankruptcy, Rasor obtained substantial personal loans from MNB Bank and Standard Federal Bank. Rasor used his relationship with Carson Fischer and his allegedly substantial income from Carson Fischer to justify these loans. Then, to repay those loans, Rasor stole money from the Firm.

Rasor did so by taking Firm checks made payable to MNB and presenting those checks to MNB tellers. At Rasor's request, MNB then deposited those checks in Rasor's accounts, not in the Firm's accounts. MNB did so without endorsing the checks to Rasor[8] and without requiring Rasor to endorse the Firm's checks. By paying Rasor the proceeds of the Firm's checks, MNB allowed Rasor to benefit himself and MNB because the Firm's money was used to repay Rasor's personal loans to MNB.[9]

By not endorsing the checks to Rasor and by not requiring Rasor to endorse the checks, MNB allowed Rasor to disguise the fact that he and MNB had caused the Firm's money to be deposited for the benefit of Rasor and MNB.

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[8] Since the checks were made payable to MNB, MNB would be required to endorse the checks to Rasor before Rasor could become the "payee." See UCC Section 3-201(2), MCL 440.3201(2): ". . . if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its endorsement by the holder."

[9] After Rasor's embezzlement scheme was discovered in October, 2000, a MNB investigator, Carolyn Bunn, created a report which traced the history of Rasor's deposits of Firm

Some, but not all, of the Firm's checks contained a number in the "Memo" line. MNB now contends that this number was the number of a Rasor account at MNB.[10] However, MNB did not produce any evidence from Rasor or from anyone else to establish this fact; and this fact was not at issue when the Circuit Court granted MNB's motion based on UCC Section 4-406.

MNB did not produce any evidence from the tellers who actually dealt with Rasor. MNB produced no evidence from anyone that MNB relied on, or even considered, the "Memo" line of the checks which Rasor presented to MNB.

None of the checks made payable to MNB were endorsed by MNB to Rasor, nor were they endorsed by Rasor. MNB offered no evidence to explain why it allowed the Firm's proceeds to be paid to Rasor's accounts without an endorsement.

I. Rasor's Relationship With MNB

Rasor had substantial contact with MNB in his capacity as the Firm's office manager. In addition to his business contacts on behalf of the Firm, Rasor was also a customer of MNB. Rasor held several personal accounts with MNB and obtained a variety of loans or credit lines from MNB. Complaint, ¶¶ 22-23 (14a) and *see, generally,* Capital Reserve Line of Credit (MNB00080 and MNB003285); Discretionary Revocable Trust Account (MNB00016); Account Opened (MNB002169); Account Statements (MNB002740).

II. The Content Of The Firm's Checks

The Firm used printed checks. Each printed check contained a line with the words "PAY TO THE ORDER OF." *See* Appellants' Appendix pp. 198a-208a. The Firm's checks at issue in

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checks and his use of those Firm checks to repay loans to MNB and Standard Federal. Bunn Dep., pp. 35-38, 52-53, 58-63 and 68-70 (20b-27b).

[10] Michigan National does not cite to any record evidence establishing the numbers on the check are Rasor's account numbers.

this case contained these words: "PAY TO THE ORDER OF: *** MICHIGAN NATIONAL BANK ***." Appendix pages 199a-208a contain several of the MNB Checks as examples.

Most checks also contained words on the "for" or "memo" line. Some of these contain a number which MNB contends was the number of an account which Rasor had at MNB.

The Firm's expert, Dr. Austin, stated that entries on the "memo" line do not alter to who the check is payable. Dr. Austin's Aff., ¶ 7 (232a).[11]

III. To Allow Rasor To Repay His Loans, MNB Misapplied The Proceeds Of Firm Checks To Rasor's Accounts

Rasor obtained signatures on Firm's checks made payable to MNB from a Firm partner, usually Mr. Joseph Fischer. Rasor represented to the Firm partner that the checks would be used to transfer funds to the Firm's accounts at MNB where they would be used for Firm purposes. Fischer Dep. pp. 42-44 (15b).

Rasor took the checks to MNB but he did not deposit them into the Firm's accounts. Instead, he somehow convinced MNB to deposit the proceeds into Rasor's accounts at MNB. Typically, Rasor used the MNB Checks to reduce the principal on his personal lines of credit. Rasor would then withdraw funds from the lines of credit in the amount of the MNB Check to fund other loans and obligations.

Even though MNB was the named "payee," MNB did not endorse the checks for the benefit of Rasor. Nor did MNB require Rasor to endorse the checks. Bunn Dep., p. 57 (25b).

MNB's practice of permitting Rasor to deposit the Firm's MNB Checks for the benefit of Rasor was a violation of well-established banking practices. Dr. Austin's Aff., ¶¶ 4-7 (232a).

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[11] UCC Section 3-109, MCL 440.3109, makes clear that only the "pay to the order" line, not the "memo" line defines a party's obligations by identifying the person to be paid.

MNB did not seek the Firm's consent before allowing Rasor to deposit the proceeds from the Firm's checks to Rasor's accounts.

If MNB had sought confirmation from the Firm, as it was required to do, the Firm would have been alerted to Rasor's fraudulent conduct; and the whole scheme would have been thwarted the very first time Rasor sought to convert a Firm check to his own account. This fact is demonstrated by the fact that when MNB did bring Rasor's fraudulent conduct to the Firm's attention, the Firm immediately took action and prevented further embezzlement.

IV. The Evidence Concerning The Signatures On The Firm's Checks

A. The Firm's Partners Testified That The Checks Were Signed For The Purpose Of Transferring Monies To Identified "Payees" And That As To The MNB Checks, The Intended Payee Was MNB For The Firm's Benefit

Joseph Fischer testified that when he was presented with checks to sign, he signed those checks with the intention that the check was "payable to a particular identified *payee*." Fischer Dep., pp. 36 and 95-96 (14b and 17b) (emphasis added); Carson Dep., p. 120 (9b) ("I looked at the payee.").[12] When asked about the numbers allegedly placed by Rasor on the MNB Checks, Mr. Fischer confirmed his intention: "That's correct. And consistent with my prior testimony, Mr. John, ***I would focus upon was the correct payee on the check. In the instances you've made references to it is Michigan National Bank***." Fischer Dep., p. 99 (17b)(emphasis added); *see also* Carson Dep., p. 121 (9b) ("The numbers you just read mean nothing to me without

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[12] The Firm has attached additional pages from the deposition testimony of Robert Carson and Joseph Fischer not cited below because this Court's grant of leave implicates facts not necessary to the issues previously addressed in this matter. The additional pages in the appendix are designated by an "*" next to the appendix page number (e.g., the additional pages will be designated as "XXXb*").

looking at something"). When asked about the numbers in the "memo" line of the MNB checks, Mr. Carson testified:

> No. No. I believe that Michigan National Bank, taking a firm check that we wrote to it and depositing it in Michigan National Bank, was obligated to deposit for our benefit or to our account. And I never worried about it.
>
> Now if that check had been changed to some other institution or changed the amount, I would worry about Michigan National taking my check from my company and applying it to some third-party's account. It never occurred to me that this could happen. [Carson Dep., p. 132 (10b).[13]]

Mr. Carson also made clear: "But under no circumstances could I, did I believe that Michigan National could have taken a firm check written on our business and applied it to some third-party's obligation." Carson Dep., p. 133 (10b). Thus, the Firm intended that the designated "payee," not a reference in a "for" or "memo" section, would determine who would receive the funds from the check.

The Firm's principals also confirmed that when they signed the MNB Checks, they intended that the checks would be used to discharge a Firm obligation, typically tax liabilities. *Id.*, Fischer Dep., pp. 43-44 (15b).

B. MNB's Expert Fraud Examiner, Carolyn Bunn, Concluded That The Firm's Signatures Were Genuine

MNB conducted an investigation into Rasor's fraud. The primary investigator was Carolyn Bunn, a long-time employee in MNB's fraud unit. Ms. Bunn issued a report on the fraud, but it did not conclude that the signatures had been forged or that there were other material

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[13] Mr. Carson's testimony hits on the key point. Assuming there was an "alteration" as alleged by Michigan National (*e.g.*, the insertion of the account number after the check was signed), the alteration was not *material* because it did not alter the "payee" or the amount of the check, so the alleged "alteration" was not relevant to a review of the checks.

alterations. Instead, Carolyn Bunn testified that MNB reviewed signatures on the checks and, based on this review: "We felt that they were good signatures." Bunn Dep., p. 69 (27b).

C. Mr. Fischer, Who Signed The Checks, Testified That The Signatures Appeared To Be His Signatures

Mr. Fischer was shown copies of some of the checks at his deposition. He testified that the signatures appeared to be his. He also speculated that because he not examined all of the actual checks prior to his deposition, "it was possible" signatures on some of the checks was forged. Fischer at pp. 94-95 (16b).

D. The Firm's Complaint Did Not Unambiguously Admit That There Were Forged Signatures Or Alterations

MNB relies on one paragraph in the Firm's Complaint, Paragraph 50, which alleged:

> 50. As part of the Fraudulent Scheme, Rasor presented checks with forged signatures or endorsements to MNB, and MNB charged those checks to the Firm's accounts, even though the checks were not properly payable.

MNB ignores the very next paragraph, Paragraph 51, which states:

> 51. The checks were not properly payable because (1) the persons signing those checks as or on behalf of the drawer did not intend payment to Rasor, and (2) MNB made payment on the checks without endorsement.

The Firm did not deny that it signed the checks with the intention that they be paid to MNB for the benefit of the Firm. Nor that it contend that MNB would not have been authorized to deposit the checks in the Firm's accounts. It contended only that MNB was not entitled to deposit the checks to Rasor's benefit.

Indeed, the Complaint accurately described the fact that the checks submitted to MNB by Rasor appeared to be used for the benefit of Carson Fischer:

> 35. Rasor would then fraudulently submit checks or other documents to Michigan National which appeared to transfer the Firm's funds to the care of Michigan National but which, in reality, transferred the Firm's funds to Rasor's own account, including Rasor's loan accounts.

> 36. By facilitating and assisting Rasor's conversion of funds from the Firm's accounts to Rasor's loan accounts, Michigan National not only kept Rasor's loans in good standing but also allowed Rasor to increase the amount of his loans, thus increasing Michigan National's own profits.

Again, the allegations make clear that the fraud being perpetrated was not that of an alteration or forgery nor do the allegations claim Michigan National was wrong for accepting forged or altered checks. The fraud alleged resulted from Rasor's ability to use checks that should have only been used for benefit of the Firm for his own purposes. That is, Michigan National paid validly issued checks to the wrong party, which means the checks were not "properly payable" to Rasor. This is the basis of the Firm's claims, not forgery or alteration.

E. The Firm's Responses To Requests For Admissions Explain The Admission In The Firm's Complaint

Defendants' Request to Admit in Paragraph 30 asked the Firm to admit "that the signatures on the MNB Checks were authorized." The Firm stated:

> the Firm denies that it "authorized" Rasor to withdraw funds from the Firm's accounts for use in the fraudulent scheme. Rasor committed a fraud against the Firm, and the Banks perpetuated this fraud through their own misconduct.

The Firm's response to Request 31 incorporated the response to No. 30 and indicated that Rasor:

> obtained signatures from members of the Firm under false pretenses, the signatures were unauthorized and arguably "forged." However, without submitting each check to a document examiner, ***the Firm cannot determine the extent to which signatures were falsified.*** [Emphasis added.]

Request No. 32 stated: "Admit that none of the MNB Checks were forged." The Firm responded:

> The Firm objects because the term "forged" is a legal term, and, therefore, the Firm ***cannot admit*** Request No. 32 as framed. Because Rasor obtained signatures from members of the Firm under false pretenses, the signatures were unauthorized and arguably "forged." However, ***without submitting each check to a document examiner, the Firm cannot determine the extent to which signatures were falsified.*** [Emphasis added.]

The Firm did not deny that the Firm signed the checks or that the Firm intended payment to MNB for the benefit of the Firm. The Firm did deny that it signed the checks with the intention that the proceeds be paid to Rasor.

F. The Alleged Variances In Signatures On The Checks Forgery

MNB now contends that there are visual variances in signatures on some of the checks. See MNB Appendix, pages 199a-201a. MNB did not offer any expert or other testimony to prove, as a matter of law, that those variances prove fraud. The testimony of Mr. Fischer and Ms. Bunn recognize that there are normal variances in a person's signature. *See* Fischer Dep., pp. 94-95 (16b) and Bunn Dep., p. 69 (27b).

V. MNB Offered No Evidence That Rasor Added His Account Number After The Firm Signed The Check

MNB argued in the Court of Appeals, and MNB's Brief, p. 24, argues to this Court, that Rasor must have altered the Firm's checks because he added his account number to the "Memo" line. The Court of Appeals held that MNB failed to show whether this was done before or after the signature was placed on the check.

VI. The Only Record Evidence Is That Michigan National's Actions Violated Standard Banking Practices and That Additions To The Memo Line Of A Check Do Not Alter To Whom The Instrument Is Payable

Carson Fischer presented the affidavit of Dr. Douglas Austin as an expert in banking practices. *See* Appendix pages 231a-234a.

Dr. Austin's affidavit confirmed that:

> 5. Standard commercial banking practices do not allow a bank to accept a check made payable to the bank for the benefit of anyone other than the maker of the checks unless there is clear and express authorization to do so from the maker.
>
> 6. When accepting checks made payable to the bank, reasonable commercial banking practices dictate that the check be endorsed.

> 10. Michigan National also did not use ordinary care where it accepted the checks made payable by Carson Fischer to Michigan National Bank for the benefit of Mr. Rasor but did not require Mr. Rasor to endorse the checks.

Critically of the issues being reviewed by this Court, Dr. Austin provides the only evidence regarding whether a bank may rely upon the "memo" or "for" section of a check to alter the payee (and a bank may not):

> 7. The "for" or "memo" section on a commercial on a commercial or personal check cannot be used to change the intent to deposit that check into the maker's account or for the benefit of the maker into a desire to deposit the check for the benefit of a third-party.

VII. MNB Offered No Evidence That It Relied On, Or Even Considered, The "Memo" Line On The Firm's Checks

MNB's Brief refers to some checks which contain a number on the "Memo" line which, MNB contends, is a Rasor account at MNB. Not all checks do so.

MNB offered no evidence that Carson Fischer knew that the number was a Rasor account number, nor did MNB offer any evidence that any MNB employee knew that the number was a Rasor account number when MNB allowed Rasor to deposit Firm checks to his own account, without endorsement by MNB to Rasor or by Rasor.

MNB also offered no evidence in the Circuit Court that its tellers relied on, or even considered, the "Memo" line when it allowed monies from the Firm's accounts to be deposited into Rasor's accounts.

STANDARD OF REVIEW

The Court should reconsider its decision to grant MNB's petition because MNB's brief establishes that this case, on this record, does not involve "legal principles of major significance to the state's jurisprudence. . . ." MCR 7.302(B). Instead, MNB asks the Court to resolve disputed issues of fact and speculate about the meaning and significance of entries on the

"Memo" line of the Firm's checks even though MNB did not offer evidence in the trial court on the meaning or significance of those entries.

If this Court addressed those issues now, it would be considering an issue raised for the first time on appeal, which was not used by the trial court as a basis for its opinion, and it would also be rendering an advisory opinion based on speculation about what the evidence might establish. *National Wildlife Federation v. Cleveland Cliffs Iron Co.*, 471 Mich. 608, 614-615, 684 N.W.2d 800 (2004).

If the Court desires to consider MNB's appeal on the merits, then it reviews the Court of Appeals' decision de novo. But, because it is reviewing a motion for summary disposition pursuant to MCR 2.116(C)(10), it must consider the evidence in the light most favorable to the Firm, not MNB. *Maiden v. Rozwood*, 461 Mich. 109, 118, 597 N.W.2d 817 (1999).

BRIEF SUMMARY OF ARGUMENT

The Court of Appeals correctly held that the Firm's checks were not "properly payable" to Rasor, and, therefore, MNB could not properly charge the Firm for monies which MNB deposited to Rasor's accounts. The Court of Appeals decision was based on UCC Section 4-401, MCL 440.4401, which provides, in pertinent part:

> WHEN BANK MAY CHARGE CUSTOMER'S ACCOUNT.
>
> (a) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

There was no dispute that the Firm freely signed checks made payable to MNB. By making its checks payable to MNB, the Firm intended that MNB receive the funds for deposit in the Firm's accounts; and it authorized MNB to deposit the funds in the Firm's accounts. The

Firm did not, however, intend, or authorize, deposit in Rasor's accounts. Therefore, the Firm's checks were "properly payable" to the Firm; the checks were not "properly payable" to Rasor.

Because the Firm's checks were not "properly payable" to Rasor, the Court of Appeals correctly concluded, applying the UCC and legal principles well established throughout the United States, that MNB was required to recredit the Firm's account for monies improperly paid to Rasor. *See* cases cited in Footnote 2.

In an attempt to circumvent the well-established rule applied by the Court of Appeals, MNB relies on Section 4-406 which imposes a duty on a customer to "discover and report his or her ***unauthorized signature on or any alteration*** on the item. . . ." [Emphasis added.] However, as the Court of Appeals and other courts considering this question have concluded, Section 4-406 was not intended to apply to scams, like Rasor's scam, which diverted the proceeds of checks properly payable to a bank without changing the check itself. *See* discussion at p. 29 below.

Considered in the light most favorable to the Firm, there were no unauthorized signatures or alterations as those words are used in the UCC. MNB presented evidence which proved only that MNB was not authorized to pay the proceeds of the checks for Rasor's benefit and that Rasor engaged in a fraud on the Firm when he procured checks, intended for deposit in the Firm's accounts at MNB, with the intention of diverting the proceeds of those checks to Rasor's accounts. The Court of Appeals properly concluded that this evidence did not establish either an unauthorized signature or an alteration within the meaning of Section 4-406.

When it granted leave, this Court asked the parties to brief whether entries in the "Memo" line of some of the Firm's checks might establish an alteration. *See* Footnote 5. MNB's brief demonstrates that the Court's question cannot, and should not, be resolved in MNB's favor on this record.

First, provisions of the UCC addressing an "alteration" make clear that the entries on the "Memo" line in this case do not constitute an alteration because they do not, and cannot as a matter of law, change the "payee" of the instrument or otherwise change the drawer's obligations. At best, MNB can only argue that, under some circumstances, entries on the "Memo" line might create an ambiguity about the identity of the "payee." However, the UCC makes clear that an ambiguity would not excuse MNB's payment to Rasor; it would instead impose an obligation on MNB to ask the Firm whom it intended to pay. Obviously, MNB did not do so; and, therefore, it paid Rasor at its peril.[14]

Second, even if on some record, a bank might be able to argue that entries on the "Memo" line excused its paying monies to someone other than the person or entity identified as "payee," this record does not allow such a conclusion. MNB did not make this argument in the Circuit Court. MNB did not, and cannot, present any undisputed evidence about the meaning or significance of the "Memo" line. MNB's own fraud investigation did suggest that MNB relied on the "Memo" line, and MNB presented no evidence that it relied upon, or even considered, the "Memo" line.

Given the absolute absence of an evidence that MNB considered the entries on the "Memo" line, the Court would be only speculating about whether this case should create an

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[14] If changes to the "Memo" line might sometimes constitute an "alteration" triggering Section 4-406, that would not justify dismissal of the Firm's claims on summary disposition, much less justify dismissal of the Firm's claims in their entirety. The limitations period in Section 4-406 applies where the customer does not "discover and report his or her unauthorized signature on or alteration on the item"; and, thus, the limitation period is limited to those items which contain either an unauthorized signature or alteration. If the factfinder determined that some checks might be "altered" within the meaning of the UCC because Rasor inserted his account number on the "Memo" line after the checks had been signed, that would not trigger the limitations period for checks which had not been so altered.

exception to the clear language of the UCC provisions defining the meaning and significance of an "alteration."

I. The Court Should Reconsider Its Decision To Grant Leave And Refuse To Consider A Issue Not Raised In The Trial Court Where The Record Would, In Effect, Require This Court To Render An Advisory Opinion Based On Speculation About What The Record Might Be

Whether entries on the "Memo" line constitute an "alteration" within the meaning of Section 4-406 was not at issue in the Circuit Court; and, therefore, it should not be considered now. *See Citizens' Mut. Auto. Ins. Co. v. Houtz*, 361 Mich. 309, 310, 104 N.W.2d 763 (1960) ("... the first stated question was neither raised nor considered in the court below. Recalling again that this is a court of review rather than trial anew, it must be held that the question is not open for appellate consideration."); *Harris v. Pennsylvania Erection & Construction*, 143 Mich.App. 790, 795, 372 N.W.2d 663 (1985) ("Although we generally will not review issues raised for the first time on appeal, where the question is one of law which is to be decided without reference to material issues of fact in dispute and review is necessary to a proper determination of the case, we will consider the issue.").

The meaning and significance of the "Memo" line is a legal issue; but it is an issue defined by the UCC Section 3-109, MCL 440.3109, Section 3-110, MCL 440.3110, and Section 3-407, MCL 440.3407. Section 3-109 provides that the "payee" of an instrument is determined by the "pay to the order" language. Section 3-110 provides that person to whom an instrument is payable is determined by the "intent" of the person signing the instrument. Section 3-407 provides that an "alteration" is not material unless it changes a party's obligation.

These provisions establish that only MNB was the "payee." They preclude a determination, as a matter of law, that Rasor was the payee or that an entry on the "Memo" line could be deemed, as a matter of law, an "alteration" making Rasor the "payee."

Given the limited record on this issue, which was not considered by the Circuit Court, the Court would be engaging in speculation and rendering an advisory opinion if it attempted to predict how entries on the "Memo" line might affect MNB's liability. It would be improper for this Court to do so. *National Wildlife Federation*, 471 Mich. at 614-615.

That is especially true where, as here, the advisory opinion favoring MNB would create chaos in the banking industry, requiring banks to consider not just the "pay to the order" line but also the "memo" line in deciding who is the proper payee of a check.

II. The Checks Were Made Payable To The Order Of MNB, And, Therefore, As The Court of Appeals Properly Held, They Were Only Properly Payable To The Firm; As A Result, MNB Was Liable Because It Credited The Proceeds To Rasor, Rather Than The Firm

There was no dispute that all of the Firm's checks were drawn on MNB and made payable to the order of MNB. As "drawee," MNB was bound by the Firm's "order." Section 3-109(2)(b) states:

> (2) A promise or order that is not payable to bearer is payable to order if it is payable:
>
> (a) To the order of an identified person.
>
> (b) To an identified person or order. A promise or order that is payable to order is payable to the identified person.

Thus, the Firm's checks were "properly payable" to the identified person, MNB, but not to Rasor.[15] And, because MNB was the payee, the Court of Appeals correctly concluded that the checks were only "properly payable" to the Firm's accounts at MNB. The Court of Appeals conclusion was based on the express language of Uniform Commercial Code, its prior decision

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[15] As Section 3-201(b), MCL 440.3201(b), states: "An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person."

in *Allis Chalmers*, and cases in state and federal courts throughout the United States. *See* Footnote 2.

UCC Section 3-110 makes clear that a check or other instrument is payable to the person intended by the maker to receive the funds.

This result is consistent with the agreement between MNB and the Firm. As the Illinois Supreme Court explained in *National Bank of Monticello v. Quinn*, 533 N.E.2d 846, 849 (1988): "A checking account creates a contractual, debtor-creditor relationship between a bank (the drawee or payor bank) and its customer (the drawer); under this contract, a bank has an absolute duty to its customer to pay only the payee(s) named on a check."[16] The Illinois Supreme Court cited its prior decision in *Cosmopolitan State Bank v. Lake Shore Trust & Savings Bank*, 175 N.E. 583, 584-85 (Ill. 1931), which held that a drawee bank is "bound to pay the amount of the check of the drawer to the payee or to its order, and to no other person," explaining:

> [t]he general rule is well settled that the obligation of a bank is to pay, on demand, the funds of the depositor to the payee named in each check, or to his order or to bearer, as the check may direct, and it must ascertain at its peril the identity of the payee and the genuineness of the indorsements, though each indorsement is a guaranty of all prior indorsements.

See also Cincinnati Ins. Co. v. First National Bank, 407 N.E.2d 519, 522 (Ohio, 1980) ("The properly payable rule of the UCC is a codification of the common law rule that there arises between a bank and its depositor customer an implied contract 'requiring the bank to obey the

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[16] In *National Bank of Monticello*, the drawer named a partnership as the payee; the partnership's general partner, who was an authorized signatory on the partnership account, endorsed the check but deposited it into his personal account instead. Ten months later, the drawer demanded that the bank recredit his account, claiming that the check had not been "properly payable" under Section 4-401. The Illinois Supreme Court ruled in the drawer's favor, holding that "when a check is made payable to order * * *, the drawer has the right to expect that the named payee has indorsed the check and thereby directs further negotiation or, in the

explicit orders of its customer prior to making payment on an item.' ");[17] *First State Bank of Wichita Falls v. Oak Cliff Sav. & Loan Ass'n*, 387 S.W.2d 369 (Tex. 1965) (under contract of deposit, bank obligates itself to pay funds to such persons or entities as depositor may direct and to no others); *Chilson v. Capital Bank of Miami, Fla.*, 701 P.2d 903 (Kan. 1985) (bank is under contract to disburse money standing to depositor's credit only upon his order and directions).

Because the checks were not "properly payable" to Rasor, the Court of Appeals also correctly concluded that MNB was required to recredit the Firm's accounts for all amounts improperly paid to Rasor. In doing so, the Court of Appeals relied on the express language of Section 4-401, its prior opinion in *Allis Chalmers* and cases in state and federal courts throughout the United States.

In *Allis Chalmers*, the plaintiff sought to purchase vehicles from Breton Shell and then lease the vehicles back to Breton Shell. Plaintiff gave Breton Shell a check for $114,737, which allegedly represented the amount owed by Breton Shell to the bank for the vehicles. The check was payable to Byron Center Bank. Breton Shell took the check to the bank and had the funds deposited into various accounts owned by it or its president. Plaintiff sued claiming the bank was not entitled to pay Breton Shell. The Court of Appeals found that the bank was required to recredit the customer's account for payments improperly made to Breton Shell. In doing so, the Court of Appeals observed:

> The trial judge, we think properly, applied the following general rule with regard to checks drawn to the order of a bank:

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alternative, that the funds have been deposited only in the account of the named payee. Failing this, the drawer may succeed in a section 4-401(1) claim." 533 N.E.2d at 851.

[17] The Ohio Supreme noted: "This approach is one recognized by authorities on the Uniform Commercial Code, as well as case law from other jurisdictions," citing cases and authorities. 407 N.E.2d at 523.

> "Where a check is drawn to the order of a bank to which the drawer is not indebted, the bank is authorized to pay the proceeds only to persons specified by the drawer; it takes the risk in treating such a check as payable to bearer and is placed on inquiry as to the authority of the drawer's agent to receive payment." (Footnotes omitted.) 9 CJS, *Banks and Banking*, § 340, p. 683.
>
> *See also* 10 Am.Jur.2d, *Banks*, § 560, pp. 529-530. See generally, Anno: *Liability of bank which diverts checks or drafts drawn to its order to a use other than that of the drawer,* 82 A.L.R. 1372 (1933). [129 Mich.App. at 606.]

See also McIntosh v. Detroit Sav. Bank, 247 Mich. 10, 17-18, 225 N.W.2d 628 (1929) (bank liable where it dealt with partnership funds without making inquiry of the other partner at its peril). As the federal Seventh Circuit Court of Appeals stated in *Mutual Service Cas. Ins. Co. v. Elizabeth State Bank*, 265 F.3d 601 (7thCir. 2001): "This general proposition enjoys the **unwavering support** of a vast body of judicial opinion originating both before and after the creation of the U.C.C. . . ." [Emphasis added.]

Allis Chalmers specifically relied on *Bank of So. Maryland*, 389 A.2d 388. In that case, a Corporation brought action against a bank to recover amounts which the corporation had lost when the bank treated checks made payable to the bank as bearer paper and permitted an employee of the corporation to divert proceeds of the checks to his own use.

PWA Farms, Inc. v. North Platte State Bank, 371 N.W.2d 102, 105 (Neb. 1985), is also instructive:

> DRW issued the check in question to the defendant [bank] as the payee. However, DRW intended to maintain control of the check insofar as it was to be used to make a payment to MONY. DRW was the "owner" of the check and may maintain an action for conversion against the defendant. The defendant was not instructed as to the disposition of the check but should have been on notice that the check should not have been negotiated until further instructions were received from DRW. By applying the proceeds of the check against Glenn Williams' personal loan, the bank was clearly exercising a wrongful act of dominion over the proceeds of DRW's check. It is elementary that when **a check is drawn to the order of a bank and the drawer gives no specific instructions as to the disposition of the funds,**

> **the bank has no right to pay the proceeds of the check to a stranger to the transaction.** The bank wrongfully converted DRW's check. * * *
>
> In the instant case the defendant bank affirmatively took the risk when it contacted Williams to inquire as to what to do with the proceeds of the DRW check. The bank could have just as easily contacted DRW for instructions or, in the alternative, returned the check to DRW. Both of these actions would have been reasonable under the circumstances. **The bank was put on notice and had a duty to inquire as to what to do with the proceeds of the DRW check. It breached this duty when it negotiated the check without receiving instructions from DRW.**

Another case, on analogous facts, is *Dalton & Marberry*. In the words of the Missouri Supreme Court:

> Dalton & Marberry, an accounting firm in Columbia, Missouri, maintained an account at NationsBank (formerly known as Boatmen's Bank of Mid-Missouri) to perform payroll services for its clients. Between November 1989 and April 1994 Janet Hollandsworth, a former Dalton & Marberry staff accountant, embezzled $130,334.00 from this payroll account. Hollandsworth carried out the scheme by having Dalton & Marberry checks drawn on the bank signed by an appropriate signatory. After obtaining a signature on a check, which was made payable to the bank, Hollandsworth would take the check to the bank and obtain a blank cashier's check or a money order. She did this approximately 93 times in four and one-half years. Dalton & Marberry officers did not know about the scheme until May 1994. During the entire period, the bank did not inquire as to whether Hollandsworth was authorized to obtain blank cashier's checks or money orders in exchange for Dalton & Marberry's checks made out to the bank and drawn upon the bank. [982 S.W.2d at 232.]

The accounting firm sued the bank, alleging that the checks were not properly payable to the employee and that, when the employee presented the checks to the bank, the bank had a duty to inquire of the customer whether it intended the proceeds to be paid to the customer. The Missouri Supreme Court agreed, noting that its decision was "consistent with the majority of other jurisdictions," citing, among its example, the Michigan Court of Appeals' decision in *Allis Chalmers*. 982 S.W.2d at 232 and n. 2. It also cited its own prior decision in *Martin v. First National Bank in St. Louis*, 219 S.W.2d 312 (Mo.1949):

> *Martin* arose from facts remarkably similar to the present case: Plaintiff's claim was that three checks drawn on and payable to the defendant bank were charged against plaintiff's account without plaintiff's authority or consent. *Martin, supra* at 314. There, as here, a miscreant bookkeeper obtained valid signatures of persons authorized to sign checks for the plaintiff, presented the checks payable to the bank, and received cashier's checks in the amount of the checks presented. *Id.* The basis of the plaintiff's claim in *Martin*, as here, is that the bank was negligent in failing to inquire as to the authority of the person who presented the checks made payable to the bank and received cashier's checks in exchange. *Id.* The Court stated that a payee bank is liable where a check is made payable to its order and the proceeds are diverted to a use other than that of the drawer-depositor, if the bank does so without authority emanating from the drawer-depositor. *Id.* at 318. *See also, Utley Lumber Co. v. Bank of Bootheel*, 810 S.W.2d 610, 612 (Mo.App.1991). A payee bank is liable if it fails to inquire as to the authority of an agent of the drawer-depositor who wrongfully diverts the proceeds of a check made payable to the order of the bank itself. *Id. See, C.J.S. Banks and Banking*, vol. 9, section 327, pp. 316-317 (1996).

Here, the Firm's checks were made payable to MNB. Thus the checks were only properly payable to the Firm. They were not properly payable to Rasor. When MNB allowed the proceeds of the Firm's checks to be paid to Rasor's accounts, MNB did so at its own risk. MNB could have avoided that risk by contacting the Firm. It did not do so. Therefore, as a matter of law, MNB was liable to the Firm for all amounts it paid to Rasor.

III. Section 4-406 Does Not Apply Because The Signatures On The Firm's Checks Were Genuine, The Firm Intended Its Funds To Be Paid To MNB For The Benefit Of The Firm's Accounts, And MNB Is Liable Not Because It Paid On Unauthorized Signatures But Because It Wrongfully Disbursed Proceeds To Rasor, Not The Firm

MNB tries to avoid liability by invoking Section 4-406; but, as the Court of Appeals properly determined, on this record, Section 4-406 does not apply because MNB did not produce undisputed evidence that the Firm's checks contained unauthorized signatures or alterations which allowed payment to Rasor's accounts rather than the Firm's accounts.

A. Section 4-406(6) Applies Only Where The Checks Or Bank Statements Disclose An Unauthorized Signature Or Alteration

Specifically Section 4-406(6) states:

> Without regard to care or lack of care of either the customer or the bank, a customer who does not within 1 year after the statement or items are made available to the customer (subsection (1)) discover and report his or her ***unauthorized signature on or any alteration*** on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under section 4208 with respect to the unauthorized signature or alteration to which the preclusion applies. [Emphasis added.]

Section 4-406 applies only to "unauthorized signatures" on checks or "alterations" of checks. As the case uniformly hold, Section 4-406 does not apply where there had been an unauthorized disbursement of properly signed checks. As the Missouri Supreme Court succinctly stated in *Dalton & Marberry,* 982 S.W.2d at 237: "The statutes [citing Section 4-406] create a duty on the part of the customer in situations involving forgery and alteration, but they do not create a duty for the customer to discover the type of scam involved here."

In *Transamerica*, the Oregon Supreme Court was asked whether checks with genuine signatures made payable to a bank but disbursed to a third-party were subject to the limitations of Section 4-406. The court concluded that Section 4-406 did not apply:

> Although the resolution by its terms precludes plaintiff from contending that the signatures on the checks were not authentic or not authorized, that preclusion does not dispose of the issues in this case. Plaintiff has charged defendant with improper disposition of money on deposit in plaintiff's account, not because defendant paid checks which bore unauthorized facsimile signatures, but because defendant credited the checks which were made payable to the bank to the accounts of Smith and Coe. The issue is not whether the bank should have accepted the signatures on the checks as valid, but whether, assuming the validity of the signatures, the bank was justified in transferring funds represented by the checks to the accounts of third parties who were not the named payees. * * *
>
> Although the Uniform Commercial Code governs the relationship between a payor bank and its customers, there are no provisions which cover the precise facts of this case. The Code has not displaced the general rule that, without authority from the maker or other acceptable justification, 'a check drawn to the order of a bank precludes the diversion of the proceeds of such check to a use other than that of the drawer * * *.'

> The checks involved in this case were not altered and, as we have pointed out, plaintiff is not in a position to assert that the signatures were unauthorized. Therefore, neither of these statutes [i.e. § 3-406 and § 4-406] is applicable according to its express terms. * * * [558 P.2d at 333-335.]

See also Govoni & Sons Const. Co., Inc. v. Mechanics Bank, 742 N.E.2d 1094, 1102 (Mass.App. 2001) (rejecting bank's Section 4-406 defense because the Govonis do not assert an alteration or unauthorized signature, but an improper disbursal of the check proceeds); *Bank of So. Maryland,* 389 A.2d at 395-97 (holding bank liable where it permitted an individual to direct the distribution of the proceeds of a check payable to the bank in violation of the drawer's intentions and observing: "Robertson's is not asserting an unauthorized signature or alteration against the bank, and thus § 4-406(4) does not bar its recovery").

In *Quilling v. National City Bank of Michigan/Illinois*, 2001 WL 1516732, 46 UCC Rep.Serv.2d 207 (N.D. Ill. 2001), the plaintiff asserted a variety of common law claims against the defendant, National City Bank, for losses caused when an admittedly authorized individual withdrew monies from a bank account and used those monies for improper, unauthorized purposes. National City Bank claimed these common law claims were barred by Section 4-406, even though there was no evidence of an unauthorized signature or a forgery. The federal district court rejected National City Bank's Section 4-406 defense:

> The court is at a loss to understand the relevance of § 4-406 in the present case. As noted above, Benson was an authorized signatory on Lennox's account at National City and is the one who signed most of the transfers and checks to move funds out of the account (with the exception of one by Loutos, who was also a signatory on the account at the time). Quilling's claims thus have nothing at all to do with any "unauthorized signatures." The only thing "unauthorized" about Benson's withdrawals was that they violated the Secured Investment Program Agreement, and what ***National City apparently has in mind is to apply § 4-406 to all types of unauthorized withdrawals, not just those involving unauthorized signature. The plain language of the statute, however, clearly encompasses only the latter,*** and National City offers no principled basis to expand the scope of the statute to cover the former. In fact, the two cases it cites where the courts actually

> applied § 4-406 both involved some sort of unauthorized signatures. [Emphasis added.]

The cases cited by MNB confirm this. *See Sciecinski v. First State Bank of East Detroit*, 209 Mich.App. 459, 461, 531 N.W.2d 768 (1995) (forged power of attorney); *Wetherill v. Putnam Investments*, 122 F.3d 554 (8th Cir. 1997) (fraudulently signed and endorsed checks triggered Section 4-406); *Concrete Materials Corp. v. Bank of Danville & Trust, Co.*, 938 S.W.2d 254 (Ky 1997) (alterations to and duplicate deposit slips); *Brighton, Inc. v. Colonial First Nat'l Bank*, 176 N.J.Super. 101 (1980) (forgeries); *New Gold Equities Corp. v. Chemical Bank*, 674 N.Y.S.2d 41 (N.Y. App.Div. 1998) (forgeries); *Watseka First Nat'l Bank v. Horney*, 292 Ill.App.3d 933 (1997) (forgeries); *Dow City Cemetery Ass'n v. Defiance State Bank*, 596 N.W.2d 77 (Iowa 1999) (forged signatures).

B. As The Court Of Appeals Properly Found, Neither The Checks Nor The Bank Statements Disclosed Unauthorized Signatures Or Alterations

MNB obtained summary disposition based on Section 4-406 even though its own fraud examiner, Ms. Bunn, concluded that the signatures were genuine, and even though MNB did not offer competent **undisputed** evidence of an unauthorized signature or alteration. Faced with this record, the Court of Appeals properly found that MNB had proven, as a matter of law, that Section 4-406 did not control.

At best, MNB offered speculation and snippets of testimony or pleadings which MNB contended could establish "forgery." Even this speculation, however, did not rise to the level of evidence which would establish that there was an "unauthorized signature" or "alteration" of the type which would trigger Section 4-406.

More importantly for present purposes, MNB was not arguing to a jury; it was seeking summary disposition under MCR 2.116(C)(10), which required MNB to prove that the facts were undisputed and that, viewed in the most favorable to the Firm, the facts established, as a

matter of law, that there were unauthorized signatures or materials alterations. MNB did not meet this burden.

As noted above, Mr. Fischer testified that he believed his signatures were genuine. MNB's fraud examiner, Ms. Bunn testified that the signatures appeared genuine. This evidence, alone, was sufficient to defeat summary disposition.

MNB also relied on allegations in the Firm's complaint, but it took those allegations out of their proper context.[18] The complaint was alleging, as Paragraph 51 made clear, that Rasor obtained signatures under false pretense. Taken in the light most favorable to the Firm, the Complaint alleged that the Firm recognized proper persons at the Firm signed the checks, but those properly signed checks were misused by Rasor, and his depositing of the properly signed checks constituted "forgery" or "fraud" in the transactions.[19] But forgery or fraud in the transaction is not the same thing as forgery or fraud in the signatures themselves.

There simply is no basis to transform the allegations of Paragraphs 50 and 51 into a legal conclusion that the Complaint was based on fabricated signatures. Indeed, during discovery, the

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[18] In using this allegations to support summary disposition, the Circuit Court improperly construed the evidence in the light most favorable to MNB. The Circuit Court cited *Atkinson v. Detroit*, 222 Mich.App. 7, 564 N.W.2d 473 (1997), to support its reliance on the Firm's so-called admissions. But in *Atkinson*, the Court of Appeals found that the trial court erred when it accepted an admission of an officer that he was "on duty" without accepting the explanation of what the officer meant by "on duty." Similarly here, the Circuit Court erred when it accepted MNB's reading of the Firm's pleadings and discovery responses without accepting the Firm's explanation of those pleadings and discovery responses.

[19] *See People v. Susalla*, 392 Mich. 387, 392, 220 N.W.2d 405 (1974) ("it is clear that forgery includes any act which fraudulently makes an instrument appear to be what it is not. Nowhere is there a requirement that a signature is necessary, much less a fictitious one, before we can call something a forgery"); *Horvath v. Nat'l Mortgage Co.*, 238 Mich. 354, 213 N.W. 202 (1927) (genuine signature on a deed procured by fraud was a "forgery"). *See also Pamar*, 228 Mich.App. at 736 (missing endorsements are classed with forged endorsements under UCC § 4-401(3)).

Firm's principals confirmed that they had no evidence that Rasor had forged any signature; they conceded that they signed checks with the intention that they be deposited in MNB for the Firm's benefit; and, in their summary disposition briefs, the Firm expressly denied that it was relying on forged signatures.

Furthermore, even if one could assume that the allegations in Count III – captioned "Action to Recredit Drawer's Account" – alleged fabricated signatures that would not trigger Section 4-406 because the fabricated signatures did not change the Firm's obligations. Even if Rasor, not Mr. Fischer or Mr. Carson signed the checks, the checks were payable to MNB, that is, to the Firm, and, therefore, the forged signatures would not cause any diversion of the Firm's funds. It was not the signatures, it was MNB's decision to divert funds from the Firm's accounts to Rasor's account, which allowed Rasor's scheme to succeed.

And, even if the Firm's pleadings constituted an admission of an unauthorized signature and that unauthorized signature — making the check "properly payable" to the Firm, not to Rasor — somehow triggered Section 4-406, that would still not justify summary disposition. The Firm was entitled to plead in the alternative. *H.J. Tucker and Associates, Inc. v. Allied Chucker and Engineering Co.*, 234 Mich.App. 550, 595 N.W.2d 176 (1999). Where a party pleads in the alternative, those alternative allegations cannot be treated as admissions. *See Larion v. City of Detroit*, 149 Mich.App. 402, 386 N.W.2d 199 (1986) ("That is, a party should not be placed in the position of having to forego a claim at the risk of having inconsistent allegations treated as admissions").

That is especially true in this case because the Firm clarified its position in its responses to MNB's Requests For Admission. Those responses make clear that Rasor fraudulently induced the Firm representatives to sign checks under false pretenses, namely, the false pretense that

Rasor would deposit the checks into the Firm accounts at MNB. Instead, Rasor deposited the checks in accounts for his own benefit. For this reason, Rasor's actions were not authorized. The Firm did authorize MNB to accept the check for the benefit of the Firm alone. The bank statements and checks did not disclose that Rasor was getting the benefit of the funds.

The Firm was simply unwilling to be put into a trap based on differing interpretations of the word "forgery." If the Firm denied a "forgery," MNB would argue that the Firm authorized Rasor to deposit the Funds to Rasor's account. If it admitted a "forgery," MNB would argue that Section 4-406 applied, even though the Firm did not rely on falsified signatures or other material alterations to the checks. The Firm's responses, therefore, specifically recognized the ambiguity in the terms "forged" and "forgery," which can be used in many contexts, including contexts which do not require an altered signature. *See Horvath v. Nat'l Mortgage Co.*, 238 Mich. 354, 213 N.W. 202 (1927) (genuine signature on a deed procured by fraud was a "forgery") with *Grosberg v. Michigan Nat. Bank—Oakland*, 420 Mich. 707, 362 N.W.2d 715 (1984) (signatures by "authorized" persons are not "forgeries" within the meaning of the UCC).

In short, the Firm refused to make an admission where the request for admission did not define the critical term, namely, forgery. However, in its further answers and in deposition testimony, the Firm made clear that it was not asserting that there were fabricated signatures but, instead, was asserting that Rasor obtained genuine signatures under false pretenses. This admission, therefore, did not bring the Firm's claim within Section 4-406 but instead made clear that the Firm was asserting a claim under Section 4-401 of the type recognized by cases such as *Allis Chalmers* and state and federal courts throughout the United States. *See* Footnote 2.

C. *Merely Because Rasor Procured The Firm's Signatures Under False Pretences Does Not Make The Signatures Unauthorized, Especially Where The Firm's Checks Were Made Payable To MNB, Not Rasor*

MNB contends that, even if the Firm's signatures were valid, not forged, they were still unauthorized because they were made without actual, implied or apparent authority. *See* MCL 440.1201(43). MNB distorts the evidence and it ignores the language of Section 4-406 which addresses unauthorized payees.

Rasor did not dupe the Firm into signing checks made payable to Rasor. Rasor duped the Firm into signing checks made payable to MNB. The Firm's checks were signed by the appropriate parties (e.g., Robert Carson or Joseph Fischer), who had actual authority to do so. The checks were, therefore, valid and "properly payable" to MNB Bank. The Firm, therefore, was entitled to conclude, when it signed the checks, that the Firm's money was being transferred from one bank account to another. That is not a situation governed by Section 4-406.

Said another way, there was clearly fraud, but the fraud occurred after the checks were signed, when Rasor persuaded MNB to pay him monies which MNB was only entitled to pay to the Firm. Had MNB honored its obligations under Section 4-401, the Firm would have suffered no injury.

Because MNB paid the monies to Rasor, without requiring Rasor to endorse the checks, there was no evidence on the checks or on the bank statements which indicated that the signature had not authorized or that the checks had been altered in a way which changed the Firm's obligations. Therefore, MNB could not establish that Section 4-406 applied to checks which had been signed with the intention that they be deposited to the Firm's accounts at MNB.

IV. Even If Rasor Later Added His Account To Some Checks, This Would Not Constitute An "Alteration" Under The Code

UCC Section 3-407, MCL 440.3407, provides:

> (1) "Alteration" means (*i*) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (*ii*) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.
>
> (2) Except as provided in subsection (3), an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.
>
> (3) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (*i*) according to its original terms, or (*ii*) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

A party's obligation is defined by the "pay to the order of" line, not the "memo" line. As UCC Section 3-109, MCL 440.3109, explains, an instrument is not payable to bearer if an identified payee is stated. Comment 2 to Section 3-109 explains that instruments identify payees with words "to the order of" or similar language. Obviously, on a printed check, the identification occurs by the "pay to the order of" line.

Therefore, in this case, even if Rasor added his account number to the "Memo" line after the Firm's checks were signed, that would not constitute an "alteration" because it would not modify the rights of the parties, which are defined by the "pay to the order" line.

MNB cites no cases which hold that an entry on the "Memo" line modifies the payee. Instead, the cases cited by MNB prove that only alterations to the "pay to the order" line constitute an alteration within the meaning of the Code.

- *Silvia v. Industrial Nat'l Bank of Rhode Island,* 121 R.I. 810, 403 A.2d 1075 (1979), is the primary case relied upon by MNB. The wrongdoer changed the payee line from "Internal Revenue Service" to "Internal Revenue Service by John Mahoney."

- *Biltmore Associates Ltd. v. Marine Midland Bank*, 578 N.Y.S.2d 798, 178 A.2d 930 (N.Y. App.Div. 1991): Check was made payable to "Internal

Revenue Service" and changed to "Plantation Island for Internal Revenue Service." Again, the change was to the payee line.

- *Garnac Grain Co. v. Boatmen's Bank & Trust Co. of Kansas City*, 694 F.Supp. 1389 (W.D.Mo. 1988): Checks were altered when the phrase "or R.L. Millison" was added to the payee line of checks made payable to company vendors. By adding this language the check became payable to either the original payee or "R.L. Millison." But again, the change was to the payee line, not a "memo" or "for" line.

To understand the absurdity of MNB's position consider how financial institutions would now have to review checks in the following circumstances:

- A check lists the payee as John Smith and in the "for" section lists Tom James. Is the check payable to both John Smith and Tom James jointly or is the check payable to John Smith *or* Tom James[20]?
- A check lists the payee as ABC Apartments and the "for" says "April." Is the check made payable to ABC Apartments and someone named "April"?
- A check identifies Acme Motors Leasing as payee and the "for" line says 101506. Is the check made payable to Acme Motors and an account number of 101506 or is that the date the car payment is due 10/15/06?

Adopting MNB's argument would bring more, not less, uncertainty to financial transactions and it would require banks to make individualized determinations not just of the "payee" line but also any other annotation on the check and then interpret whether and how those annotations modify the "payee." MNB cannot seriously advocate that result.

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[20] Tom James is a manufacturer of men's clothing, which highlights the problem of discerning what customer's intend by the "for" section if the "for" section can alter to whom a check is payable.

V. UCC Section 3-110 Does Not Support MNB But Instead Confirms That Entries On The "Payee" Line And The Intent Of The Signer — Here The Firm — Determine Who Is The "Proper" Payee

MNB relies on MCL 440.3110 to support its argument that the "Memo" section can justify payment to Rasor. But, in doing so, MNB distorts what Section 3-110 actually says.

Section 3-110(1) states:

> (1) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than 1 person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by 1 or more of the signers.

Thus, Section 3-110(1) demonstrates that the Circuit Court could not properly enter judgment in favor of MNB because the Firm did not intend payment to Rasor; the Firm intended payment to the Firm's accounts at MNB.

MNB cites Section 3-110(3)(a), but it does so in a misleading way. MNB's Brief, p. 27, quotes this provision from Section 3-110(3)(a):

> If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable.

MNB omits the very next sentence from 3-110(3)(a), which states:

> If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

Here the Firm's checks were not paid to an account number; they were paid to MNB. Assuming one could incorporate the "Memo" section, that would not change the result because the check would include both a "named person" and an "account number." Section 3-110(3)(a) requires payment to be made to MNB, not the Rasor account.

Further, assuming that the account number created an ambiguity, MNB was not entitled to resolve the ambiguity on its own. If someone at MNB wondered whether a number in the "Memo" section meant that the Firm's checks should be paid to some other account at MNB, then MNB had the duty, under Section 3-110, to establish the Firm's intent. That, of course, would have brought Rasor's scheme to a screeching halt.

The important point, here, is that MNB's reliance on Section 3-110 is based on mere speculation. There was no evidence that any MNB teller relied on, or even considered, entries in the "Memo" section; and MNB did not make this argument to the Circuit Court.

VI. The Court Of Appeals Did Not Err When It Used The Words "Readily Apparent" To Discuss Section 4-406 And The Firm's Obligation Under Section 4-406; But, Even If It Did, That Would Not Change The Result

MNB argues that the Court of Appeals inserted a "readily apparent" requirement into UCC Section 4-406 which restricted the application of Section 4-406. MNB is wrong; and, even if MNB were correct, that would not change the result in this case because the record still contained factual disputes about the application of Section 4-406 which could not be resolved by summary disposition.

A. The Court of Appeals Did Not Misread Section 4-406

Here is what the Court of Appeals wrote:

> Section 4406 creates a duty on the part of the customer in situations involving forgery and alterations, ***both of which should be readily apparent*** to the customer upon comparison of the bank statement with the customer's own records. . . . The present case, however, does not involve forgery or alteration of checks." Opinion, p. 5 (332a) (emphasis added).

This language recognizes that Section 4-406 applies only where the customer could have "reasonably have discovered the unauthorized payment. . . " As the UNIFORM COMMERCIAL CODE COMMENT to MCL 440.4406 explains: "If the customer could not 'reasonably have discovered the unauthorized payment' under subsection (c) there would not be a preclusion

under subsection (d)."[21] The COMMENT adds: "Whether the customer has failed to comply with its duties under subsection (c) is determined on a case-by-case basis."

The "readily apparent" language simply recognizes that Section 4-406 addresses situations where it was "reasonable" to discover, based on information on the checks or bank statements, that there was an unauthorized payee or that there was change in the drawer's obligation.

B. Whether One Uses "Readily Apparent" Or "Reasonable" To Describe The Firm's Obligation, Here MNB Did Not Produce Undisputed Evidence That The Firm Should Have Discovered The Embezzlement From The Face Of The Checks Or The Bank Statements

At best, MNB presented evidence that signatures might have been "forged," but the forgeries did not change the payee or create an obligation the Firm did not intend to pay. Nothing in the checks or the statements disclosed anything to the contrary.

The Firm presented evidence that it was not reasonable for the Firm to have determined unauthorized payments from those checks or bank statements. Dr. Austin's Aff., ¶ 3 (232a).

This is where the issue of "endorsements" becomes relevant. The Firm does not contend that MNB is obligated to obtain an "endorsement" as a matter of law. But, if MNB did not do so, then MNB made it impossible for the Firm to determine, based on an examination of the checks, that there had been an unauthorized payment. That is why standard banking practice mandates an endorsement. Dr. Austin Aff., ¶ 10 (233a).

Here, as the Court of Appeals recognized, when the checks on their face confirmed to Carson Fischer that the person it intended to pay had been paid. When written, the checks at

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[21] *See, e.g., American Airlines Employees*, 29 S.W.2d at 92, a case on which MNB heavily relies, which recognizes that a customer's obligation under Section 4-406 is triggered when the

issue were made payable to MNB. When the checks were returned to the Firm, the payee was still MNB. There was no change to the named payee, nor any endorsement which would suggest someone other than MNB received the proceeds. Thus, there was no "forgery" or "alteration" to the checks which would disclose that the MNB Checks had been used to make an unauthorized payment to Rasor. Dr. Austin's Aff., ¶¶ 3, 10 (233a); Carson Dep., pp. 131-33 (10b).

VII. This Court Should Not Make New Legal Rules Governing The Obligation Of Banks — Rules Which Would Necessarily Change Banking Practices By Imposing New, Extraordinarily Burdensome Duties On Banks — Based On This Record

Faced with the undisputed fact that the Firm's checks identified MNB, not Rasor, as the "payee" of the Firm's checks, the Court of Appeals applied a rule well established throughout the United States to determine that the Firm's checks were not "properly payable" to Rasor and, therefore, MNB was obligated to recredit the Firm's accounts for all amounts paid to Rasor.

MNB now asks the Court to make a new legal rule, namely, that the "payee" of a check should not be determined solely by the entry on the "pay to the order" line but rather by considering the "memo" line in conjunction with the "pay to the order" line.

This new rule would require a substantial change in law, given the language of UCC Sections 3-109, 3-110, and 3-407, which have consistently been construed to mean that the "payee" of a standard check should be determined by looking at the "pay to the order" line.[22]

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bank furnishes "sufficient information" to determine whether there has been a forgery or alteration. The Court of Appeals "readily apparent" language makes the same point.

[22] Sections 3-109 and 3-110 are not limited to checks; they apply to all "instruments," including promissory notes. When determining the "payee" of some instruments, it may be appropriate to look at the language of the instrument as a whole to resolve ambiguities about the proper "payee."

Worse, the new rule would impose new duties on banks in Michigan which would defeat the purposes of the Uniform Commercial Code by undermining uniformity and complicating the law of commercial transactions.[23]

When they enacted the UCC, the Michigan legislature and other legislatures expressly instructed courts to liberally construe and apply the act "to promote its underlying purposes and policies. . . ." MCL 440.1102(1). *Shurlow v. Bonthuis,* 456 Mich. 730, 576 N.W.2d 159 (1998). In construing the UCC in accordance with its purposes, text of each section should be read in light of purpose and policy of rule or principle in question.

Section 1-102(2), MCL 440.1102, states:

> (2) Underlying purposes and policies of this act are:
>
> (a) to simplify, clarify and modernize the law governing commercial transactions;
>
> (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
>
> (c) to make uniform the law among the various jurisdictions.

There may be a case which warrants a new rule; but that is not this case, at least on this record, which does not contain competent, undisputed evidence about the meaning of the entries on the "Memo" line and which does not contain evidence that MNB relied upon, or even considered, the "Memo" line when it made the decision to pay Rasor even though he was not the named "payee" of the Firm's checks.

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[23] *See Putnam Rolling Ladder Co., Inc. v. Manufacturers Hanover Trust Co.*, 546 N.E.2d 904, 908 (N.Y. 1998), quoted with approval in *American Airlines Employees Fed. Credit Union v. Martin*, 29 S.W.3d 86, 92 (Tex. 2000), a case on MNB heavily relies.

CONCLUSION

This Court should affirm the Court of Appeals.

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